Year-end tax planning considerations

Move forward with confidence.

As we discussed in the first installment of the Guide, the passage of the 2017 Tax Act significantly altered the individual income tax planning landscape for 2018 and beyond. Almost two years later, aided by regulatory and other guidance, we have completed our initial pass through the maze of tax reform and come out with a better understanding of the tax impacts and potential pivot points, some of which may require action before the end of 2019. The following list of considerations is not meant to be exhaustive. It is meant to begin the conversation and may require that you revisit other sections of the Guide for a more in-depth discussion of complex topics.
With a solid understanding of the various taxes that may be assessed on your income and the importance of planning for this meaningful liability, you are now equipped to consider the issues that are presented to you based on your personal tax situation. When we say considerations, we like to think of those as levers that you can engage. Maybe your lever is to take steps to defer income to a subsequent year, or maybe it is to accelerate a deduction or expense into the current year. Or maybe your lever is to take action based on the implications of tax reform. Think of these levers as tools within your control that you can use to affect your tax result.

By implementing a long-term commitment to broad-based tax planning, you likely will identify many different levers to consider each year and position yourself to navigate today’s tax environment more efficiently. To be more effective in your efforts, consider thinking of your tax situation beyond just the income you expect to realize or the deductions you expect to incur. To only think of income planning approaches or deduction planning considerations is to think in a vacuum. That is not the way that it works when you file your tax returns—even more so after tax reform. Everything is taken into consideration when calculating your tax bill. So we encourage you to think of planning as a year-round process, taking into consideration all the levers you can pull, be they income or deduction decisions—to create a more efficient tax result.
Year-end tax planning considerations

Future events, goals, and objectives

The biggest drivers of tax planning are your personal goals and objectives. Of course, as your life and investments change, those goals may need to be reconsidered.

- Are there 2019 and 2020 life events (such as, changes in marital status, sale of a business, change in residency, etc.) that should be considered?
- Are you considering more international investments or moving globally?
- Have you, or your immediate family members, changed employers?
- Are you considering investing in any unique assets (for example, airplanes, yachts or art)?
- Are you considering the creation of a family office?
- Did you purchase or sell cryptocurrency, tokens, participate in an initial coin offering, or open a wallet at a cryptocurrency wallet hosting service?
- Are you considering a change related to tax reform, such as changing your choice of entity?
- Are you considering an investment in a qualified opportunity zone?
Year-end tax planning considerations
Planning for types of income

Ordinary income
If your primary source of income comes from employment, then you will generate ordinary income in the form of wages, salaries, tips, commissions, bonuses, and other types of compensation. Other investments may also generate ordinary income in the form of interest, nonqualified dividends, net income from a sole proprietorship, partnership or limited liability company (LLC), rents, royalties, or gambling winnings.

In order to plan regarding income, you must consider both the character and timing of that income, both of which affect the applicable tax rate.

Individual ordinary income tax rates

<table>
<thead>
<tr>
<th>Ordinary income tax rate</th>
<th>Taxable income over</th>
<th>But not more than</th>
<th>Taxable income over</th>
<th>But not more than</th>
</tr>
</thead>
<tbody>
<tr>
<td>10%</td>
<td>–</td>
<td>$9,525</td>
<td>–</td>
<td>$19,050</td>
</tr>
<tr>
<td>12%</td>
<td>$9,525</td>
<td>$38,700</td>
<td>$19,050</td>
<td>$77,400</td>
</tr>
<tr>
<td>22%</td>
<td>$38,700</td>
<td>$82,500</td>
<td>$77,400</td>
<td>$165,000</td>
</tr>
<tr>
<td>24%</td>
<td>$82,500</td>
<td>$157,500</td>
<td>$165,000</td>
<td>$315,000</td>
</tr>
<tr>
<td>32%</td>
<td>$157,500</td>
<td>$200,000</td>
<td>$315,000</td>
<td>$400,000</td>
</tr>
<tr>
<td>35%</td>
<td>$200,000</td>
<td>$500,000</td>
<td>$400,000</td>
<td>$600,000</td>
</tr>
<tr>
<td>37%</td>
<td>$500,000</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
</tbody>
</table>

Capital gains
If you have invested in a capital asset, then the gain on the sale or exchange of such an asset results in capital gain. Generally, the short-term capital gains tax rate (for assets held up to 12 months) is equal to the ordinary income tax rate. The long-term capital gains tax rate brackets (generally, assets held for more than 12 months) are shown below.

Long-term capital gains tax rates

<table>
<thead>
<tr>
<th>Net long-term capital gains rate</th>
<th>Taxable income over</th>
<th>But not more than</th>
<th>Taxable income over</th>
<th>But not more than</th>
</tr>
</thead>
<tbody>
<tr>
<td>0%</td>
<td>–</td>
<td>$38,600</td>
<td>–</td>
<td>$77,200</td>
</tr>
<tr>
<td>15%</td>
<td>$38,600</td>
<td>$425,800</td>
<td>$77,200</td>
<td>$479,000</td>
</tr>
<tr>
<td>20%</td>
<td>$425,800</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
</tbody>
</table>
Year-end tax planning considerations

Planning for entity ownership

At the root of almost every individual and family fortune is (or was at one time) a successful business. Effective tax planning may contribute to the business’ success as the business moves through its life cycle from start-up through growth, maturity, sale or ownership transition by gift or inheritance. Ultimately, the fruits of business success lie in compensation, equity distributions (including to pay related estate taxes) and other economic benefits to owners and others holding a stake in the business. Tax planning can enhance the relative benefit of these business and stakeholder interactions.

Integrated tax planning is particularly important when the business is structured as a pass-through entity. The lens through which owners will make decisions about structure or financing is now colored by lower overall individual rates, the new deduction for qualified business income and the new limitation on business interest. While no one provision can stand on its own when making important decisions—such as what type of entity structure to use in forming a business—collectively, these new planning considerations alter the analysis that an owner must undertake when determining how to move forward. (For more information, review “Choice of entity and addressing entity conversion considerations: Key provisions to consider” from installment one).

Individuals can gain significant value when they work with an adviser who can understand the entire picture, from the entity to the owners. Any tax planning you undertake at the business level needs to take into account the implications to the owners.
Business loss limitations
When thinking about entity ownership, it is also important to remember various considerations, including those listed below, regarding the deductibility of losses. For more information, read the chapter on losses.

• Do you have sufficient tax basis?
• Do you have sufficient at-risk basis?
• Are you subject to the passive loss rules?
• Are you subject to the excess business loss rules?

Self-employment income
If your income is generated by operating a business as a sole proprietor, a partner in a partnership, or a member of a multi-member LLC, you may be subject to self-employment tax in addition to your ordinary income tax. Consider establishing an appropriate retirement savings vehicle, such as a Keogh or a SEP IRA, which would allow for maximum contribution to a qualified plan based on self-employment income.
Year-end tax planning considerations

Planning for foreign investments

As we discussed in the second installment of the Guide, if you and your family are thinking of joining the globalization trend and moving and/or investing internationally, consider these questions:

- How will you manage investment, legal, immigration, tax, and accounting issues?
- What types of investment vehicles should you consider?
- Should potential estate taxes or inheritance taxes affect the structuring of your international investments?
- What are some of the tax considerations for non-US families making US investments?
- What are the potential issues for US families making investments in foreign countries?
- What effect does family mobility have on investment planning and taxation?
- Do you understand how to comply with your US and foreign country tax obligations?
- Do you know what your overall tax position will be across the globe?
- How will the 2017 Tax Act impact your global structure and cash flow?
- Are you considering selling or expanding your business or investing in new foreign investments?
- What are the considerations involved with moving your non-US business onshore?
Year-end tax planning considerations

Planning for itemized deductions

Similar to income, when planning for deductions, you must consider the nature of the deduction. If it is an itemized deduction, as opposed to a business expense, then how has tax reform changed the way you should plan?

When navigating changes regarding itemized deductions, consider:

- Changes to charitable contribution deduction and substantiation requirements
- Newly increased (60%) AGI limit for cash contributions
- New limitations on state and local tax deductions
- Deduction for foreign property tax repealed
- Repeal of miscellaneous itemized deductions
- Investment interest expense deduction
- New limitations on mortgage interest deduction
- New business interest expense limitation
- 10% of AGI limitation on medical expenses

Also consider the impact of the alternative minimum tax (AMT) (for most taxpayers, impact reduced due to tax reform and increased exemptions).

Considerations for charitable giving

Before starting charitable giving, ask yourself:

- How much wealth am I willing to part with?
- What type of assets do I have to work with?
- How much control do I want?
- What is the desired income stream for me, my family and my charity?
- What percentage of my income do I want to spend on philanthropy?
- Do I anticipate an income event that will enhance or limit the benefit I receive from a charitable donation?
- When does the charity need the funds to meet both my goals and the charity’s need for the funds?
- What is my desired timing for receiving an income tax deduction for the charitable gift?
Year-end tax planning considerations

Planning for qualified business income deductions

As we discussed in the second installment of the Guide, considerations abound regarding the new section 199A qualified business income deduction, including (but not limited to):

- Consider the qualified trade or business and specified service trade or business (SSTB) determinations and threshold application.
- Effective aggregation planning requires modeling the potential impacts of aggregating (or not) over multiple years.
- Owners of relevant pass-through entities (RPEs) will get Schedules K-1 informing them of whether any trade or business is a SSTB, but may not receive all the information necessary to conduct an aggregation analysis (especially if no aggregation is made at the RPE level). Consider if you have all of the relevant necessary information.
- Consider the impact of the overall limitation of 20 percent of the taxpayer’s taxable income without regard to net capital gain (which for this purpose includes any qualified dividend income).
- Consider the interplay with other tax rules (for example, passive activity losses and charitable contribution deduction limitations). For example, are you offsetting all of your ordinary income with a charitable contribution and therefore have no remaining income against which you can take the qualified business income deduction?
Year-end tax planning considerations

Audit readiness and identity theft

In reviewing your income tax information, you should consider the increased federal and state audit activity of high net worth individuals in areas, such as:

- Substantiation of active participation
- Substantiation of charitable donations
- Substantiation of S corporation stock and debt basis adjustment schedules for losses and stock basis for tax free distribution

Tax reform has introduced multiple areas of ambiguity. The tremendous amount of uncertainty surrounding tax reform points to an increasing risk of audit adjustments for taxpayers.

Additionally, you should safeguard your information and consider the potential for identity theft. If you need additional information about these issues, then you should consider consulting with a tax controversy specialist.

Key questions:

- How is the IRS examination approach changing?
- What information should you be prepared to provide to the IRS during an examination?
- What common tax issues arise in Global High Wealth exams?
- What leading practices help effectively manage an examination?
- What else should an individual, trustee or family office be aware of?

Exam readiness

1. Opening letter
2. Notice of adjustment prepared
3. 30-day letter
4. 90-day letter
5. Post appeals mediation
6. Court (choice of forum)
7. Fast track appeal
8. Protest
9. Respond
10. Examination
11. IRS documentation

Key questions:

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- What leading practices help effectively manage an examination?
- What else should an individual, trustee or family office be aware of?
Year-end tax planning considerations

Tax attributes

Consider what, if any, factors from your 2018 tax returns impact your 2019 tax liability, such as:

• Tax overpayments applied to 2019
• Carryovers of certain types of losses or credits, such as:
  – Short-term or long-term capital loss
  – Passive activity loss
  – Net operating loss, including those as a result of an excess business loss
  – Excess business interest expense
  – Qualified business loss
  – Charitable contribution deduction, keeping in mind the potential for expiration of the amount carried forward
  – Foreign tax credit
  – AMT credit

Future events, goals, and objectives

Planning for types of income

Planning for entity ownership

Planning for foreign investments

Planning for itemized deductions

Planning for qualified business income deductions

Audit readiness and identity theft

Tax attributes

Putting it all into perspective
Year-end tax planning considerations

Putting it all into perspective

Putting all of this into perspective may be easier when you consider these important points:

1. Items that are controllable provide flexibility for determining the more optimal time for tax recognition. This is equally applicable to items of income as it is to losses and items of deduction.

2. Some items are automatically going to occur—you will pay your real estate taxes when they are due (or face a penalty for not doing so), and you will earn your wages when they are earned. Often these automatic events lay the foundation of your planning. In essence, enhance the efficiency you can gain from your controllable events against the backdrop of your noncontrollable events.

3. Controllable deductions may be one of your biggest levers. Again, an example would be when and how you fund your charitable gifts. Will you use securities or an alternative asset? Recognizing that there are more efficient ways to fund these deductions—both in terms of the when and the how—allows you to reach a greater level of tax efficiency.

4. Your personal tax situation will afford you some additional considerations today and in future years. Making sure you review it broadly and commit to thoughtful tax planning is likely to position you to realize a greater degree of tax efficiency than you otherwise might expect.

5. If you are an owner of, or invest in, pass-through entities, do not lose sight of the fact that tax reform has changed the lens for more thoughtful planning at the entity level to position yourself for an efficient tax result. Perhaps planning within those entities to structure for the qualified business income deduction or business interest expense will take priority. Failing to coordinate tax planning between a flow-through entity and the owners of that flow-through entity may undercut tax efficiency.

6. Before acquiring new investments, take time to understand the character of the income that will be generated by the investment as well as when you will recognize the income. Furthermore, analyze whether you will benefit from the expenses and losses allocated to you. For example, losses may be disallowed in the current year if you are subject to the passive loss or excess business loss rules. Failing to understand the character of income and expenses that the pass-through entity will pass through to you may lead to unwelcome surprises when you receive the final tax information.

This Guide is meant to begin the conversation as you navigate your personal income tax planning path, specifically at the close of 2019, but more importantly year-round.